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No. 342

In the Supreme Court of the United States

October Term, 1944

Robert R. Young, petitioner

v.

The Higbee Company, William W. Boag, and J. F. Potts

On writ of certiorari to the United States Circuit Court of Appeals for the Sixth Circuit

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

Pursuant to Section 208 of the Bankruptcy Act (11 U. S. C. § 608), the Securities and Exchange Commission became a party in the district court to the present proceeding for the reorganization of The Higbee Company. The Commission took no position in the district court on the questions involved in the present appeal, nor did it participate in the appeal to the Circuit Court of Appeals. The Commission is not named as a respondent herein.

If the Commission is not properly to be regarded as a party respondent, in view of its non-

participation on the appeal below, we ask the Court to regard this brief as a brief for the Commission *amicus curiae* in support of the petitioner.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals is reported at 142 F. (2d) 1004. The opinion of the district court (R. 252–255) is not reported.

JURISDICTION

The decree of the Circuit Court of Appeals was entered on May 15, 1944. The petition for a writ of certiorari was filed on August 14, 1944 and granted October 9, 1944. The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether certain stockholders of a company in reorganization under the Bankruptcy Act are accountable for sums received by them as consideration for the abandonment of an appeal taken in the proceedings, where the appeal, if successful, would have benefited an entire class.

STATUTE INVOLVED

The question arises under Chapter X of the Bankruptcy Act but does not turn on the express language of any provision thereof.

STATEMENT

The reorganization of the debtor, a Delaware corporation which operates a general department

store in the City of Cleveland, was instituted in 1935, by the filing of a voluntary petition under Section 77B of the Bankruptcy Act in the United States District Court for the Northern District of Ohio (R. 74, 82, 221). No trustee was appointed and the debtor was permitted to remain in possession and operation of the business subject to the jurisdiction of the court. On Sepetmber 22, 1938, Chapter X became effective and on January 23, 1940, the Commission became a party to this reorganization.

The Plan of Reorganization

A plan of reorganization which had been submitted by the management was confirmed by order of the district court on October 17, 1941 (R. 181). The Securities and Exchange Commission, pursuant to Section 172 of the Bankruptcy Act, had previously examined the plan and issued its advisory report finding the plan to be fair and feasible. *In the Matter of The Higbee Company*, 8 S. E. C. 777. The Commission found that the assets of the debtor were worth between $6,100,000 and $6,300,000. The plan provided participation for the senior and junior indebtedness, and for the first and second preferred stocks. The common stock, all of which was owned by the holders of the junior debt, was accorded no participation in the reorganized enterprise.

The Appeal from the Confirmation Order

Contending that the plan awarded too great a participation in the reorganized company to the junior debt claim of $1,952,000, two first preferred stockholders of the debtor corporation, Potts and Boag, appealed from the confirmation order (R. 181–84, 8 S. E. C. 779). The disputed claim, together with the common stock, had been acquired in 1937 by Bradley and Murphy, directors of the debtor (R. 109, 113, 114).[1] Under the plan the junior debt claim was to receive $600,000 in new notes and a majority of the new common stock. Potts and Boag contended that the claim should have been subordinated to the first and second preferred stocks or in the alternative should have been allowed only in a smaller amount (R. 182–84).

Potts and Boag had earlier been members of a stockholders' committee which had contended that the junior debt claim was invalid (R. 81–87, 100). Subsequently, they had resigned from the committee in protest over the action of its counsel in approving the plan (R. 147). For a time thereafter, holding themselves out as a new committee, Potts and Boag claimed to represent other stock-

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[1] Bradley was a director and officer of the debtor at the time of the purchase (R. 109). He continued to be a director during the pendency of the appeal by Potts and Boag from the confirmation order and was also president of the debtor (R. 114, 117). During this period Murphy was also a director of the debtor (R. 117).

holders, and sought to induce other stockholders to join with them (R. 172–78, 185–87). For the purpose of this brief we assume that the court below was correct in holding that Potts and Boag, as a committee, never received specific authority from other stockholders.[2] Their appeal from the confirmation order was taken in their own names only (R. 181–82).

On March 7, 1942, after the expiration of the time within which any other security holders might have appealed from the confirmation order, Potts and Boag sold their stock (260 shares) to Bradley and Murphy, pursuant to a contract whereby they agreed to the dismissal of the appeal (R. 188–90, 223). The sale price was $115,000, although the par value of the Potts and Boag holdings was $26,000 and at that time the market value was about $17,000 (R. 188, 221). The difference between the price paid and the value of the stock was admittedly received as consideration for "selling the appeal" (R. 188). Thereafter, upon stipulation of counsel, the parties sought to dismiss the appeal (R. 55, 72).

At the time the appeal of Potts and Boag was sought to be dismissed, Young, the petitioner herein, who was a holder of 138 shares of the debtor's first preferred stock, petitioned to inter-

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[2] As we hereafter argue, *infra*, pp. 17–21, we attach no significance to this finding insofar as it affects the fiduciary obligation of Potts and Boag as members of a protective committee.

vene and to continue the appeal at his own expense (R. 67–72, 80). The parties objected to Young's intervention on the grounds, *inter alia,* that he had not objected to the plan in the bankruptcy court (R. 55, 60) and that he had "ulterior purposes" (R. 55)—apparently referring to his attempts to secure control of the debtor, which allegedly motivated Bradley and Murphy in purchasing the appeal (R. 29, 49–50, 73–79, 230–231).[3] This application was denied without opinion by the circuit court of appeals on March 11, 1942, and on the same date it dismissed the appeal (R. 72–73).

The Present Application

The instant proceeding was instituted by Young, who applied to the bankruptcy court for an order either (a) authorizing him to employ counsel to institute proceedings on behalf of the debtor against Potts and Boag for an accounting and payment to the debtor of a sum equal to the difference between the fair value of the stock sold by Potts and Boag and the amount they received, or (b) directing Potts and Boag to pay over this sum to the first-preferred stockholders of the

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[3] *Cf.* facts set forth in *In re Higbee Company*, 50 F. Supp. 114 (D. Ohio 43), affirmed *sub nom Young* v. *Bradley*, 142 F. (2d) 658 (C. C. A. 6, 1944), certiorari denied No. 496, November 13, 1944.

debtor [4] (R. 2–4). This application was denied by the district court, and the circuit court of appeals affirmed.

SUMMARY OF ARGUMENT

Since the reorganization plan challenged on appeal by Potts and Boag could not have been held unfair to them without being held unfair to all other participating stockholders of the debtor, the appeal was essentially representative—and this is no less so because the appeal was not designated as a class suit. Moreover, the former connections of Potts and Boag with a stockholders' protective committee precluded them, under the circumstances of this case, from taking their appeal solely on their own behalf.

By retaining for themselves the consideration they received for abandoning their appeal, Potts and Boag effected a result contrary to the aim of the bankruptcy reorganization statutes that security holders of the same class should receive equal treatment in the reorganization proceeding, and they thereby violated responsibilities inherent in their representative capacity. The bankruptcy court, as a court of equity, has the power and duty to correct this inequitable result. The appropriate relief is to compel Potts and Boag to pay over to the debtor the consideration they received for selling the appeal.

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[4] The original application sought relief also against Bradley and Murphy but petitioner has not made them parties in his petition to this Court.

ARGUMENT

I

THE APPEAL BY POTTS AND BOAG WAS ESSENTIALLY REPRESENTATIVE IN CHARACTER AND SUBJECTED THEM TO CONTROL OF THE REORGANIZATION COURT

1. As a result of their appeal from the order confirming the plan of reorganization, Potts and Boag received from Bradley and Murphy $115,000 for securities of a par value of $26,000 and a market value of approximately $17,000. Their appeal challenged the fairness of the reorganization plan in providing for $600,000 of new debt to compensate the disputed debt claim of Bradley and Murphy. Had the appeal been successful and the order confirming the plan reversed, no new plan could have been confirmed unless it eliminated or reduced the amount of debt securities to be issued for the Bradley and Murphy claim.[5] This would have improved the position of all public stockholders entitled to share in the reorganized corporation. Except for such compensation as the bankruptcy court might have awarded Potts and Boag for effecting this result, they would not have benefited to any greater degree than other preferred stockholders.

It is our position that whether or not the appeal was fought to a successful conclusion Potts and

[5] Since Bradley and Murphy held all of the old common stock, it is immaterial whether their debt would have been subordinated or disallowed.

Boag were not entitled to secure greater benefits from it than other security holders in the same class except to the extent that they might be awarded compensation by the bankruptcy court. We contend that in undertaking this appeal, bottomed upon class rights of participants in a bankruptcy reorganization, Potts and Boag assumed a status different from that of a party in individual litigation and undertook responsibilities which they subsequently violated in retaining for themselves the consideration they received for abandoning the appeal.

Persons suing on behalf of a class do not have unrestricted control over their litigation. Having undertaken to represent others, they are subjected to a degree of court control to protect other members of the class.[6] Thus, the courts have long since permitted intervention by other members of a class, especially when it appeared that those instituting the action might not adequately represent them,[7] and courts have refused to permit dismissal of class litigation on terms unfair to those on whose behalf the action was

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[6] Cf. *Whitten* v. *Dabney*, 171 Cal. 621, 625, 631-2, 154 Pac. 312, 315, 316-17 (1915); and see cases cited in footnotes 7 and 8, *infra*.

[7] *Southern Pacific Co.* v. *Bogert*, 250 U. S. 483, 498 (1919); and *United States Lines, Inc.* v. *United States Lines Co.*, 96 F. (2d) 148 (C. C. A. 2, 1938); and cf. *Golconda Petroleum Corp.* v. *Petrol Corp.*, 46 F. Supp. 23 (S. D. Cal. 1942); *Bowker* v. *Haight & Freese Co.*, 140 Fed. 794 (S. D. N. Y., 1905). See also Rule 24 of the Rules of Civil Procedure.

brought.[8] Similarly, dismissal and compromise of a class suit under Rule 23 of the Rules of Civil Procedure are expressly required to be with the approval of the court. As the court noted in *Cohen* v. *Young*, 127 F. (2d) 721, 725 (C. C. A. 6), in considering the application of Rule 23 to a stockholder's representative action, "the rule was adopted to secure not routine approval of a consent decree, but in order to insure supervision of the court for the protection of the corporation and all the stockholders." Thus, under Rule 23 the court may require that notice be given to all other members of the class and, where the right sought to be enforced is joint, or common, or derivative, such notice is mandatory.

The necessity for these requirements is indicated by evils which have resulted in cases where the courts have not assumed to exercise such controls. There have been numerous instances where

[8] *Whitten* v. *Dabney*, *supra*, note 6; *United States Lines, Inc.* v. *United States Lines Co.*, *supra*, note 7; *Naspo* v. *Summit Sweets Shoppe*, 106 N. J. Eq. 49, 150 Atl. 199 (1930); *Atlas Bank* v. *Nahant Bank*, 23 Pick. 480, 491 (Mass.) (1840); *Honesdale Shoe Co.* v. *Montgomery*, 56 W. Va. 397, 49 S. E. 434 (1904); McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit* (1937) 46 Yale L. J. 421, 433–35. Cf. *Denicke* v. *Anglo California National Bank*, 141 F. (2d) 285 (C. C. A. 9, 1944) where the court directed dismissal of a class action under Rule 23 (c), over the objection of the complainant stockholder, when it appeared that a new management had taken control of the corporation and had effected a compromise of the litigation on terms which the court found fair.

inequity resulted from representative suits, especially stockholders' derivative actions, because the self-appointed representatives succeeded in achieving personal benefits at the expense of those purported to be represented.[9] In *Winkelman* v. *General Motors Corp.*, 48 F. Supp. 504, 514 (S. D. N. Y.) the court pointed out: "A question of public policy had developed in actions of this type, due to the private and secret settlement of stockholders' suits, made without court review and without notice to other stockholders. Against that unsavory practice the corrective provisions of Rule 23 (c) were directed." Unsupervised settlements with these tendencies toward "unsavory practices" have sometimes been achieved through the device of purchasing the complainants' securities.[10]

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[9] *Securities and Exchange Commission Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committee* (1937), Pt. 1, 691-704; Hornstein, *Problems of Procedure in Stockholders' Derivative Suits* (1942) 42 Col. L. Rev. 574, 583-84.

[10] The recent decision of the Third Circuit in *Webster Eisenlohr, Inc.* v. *Kalodner*, 145 F. (2d) 316, illustrates the evils which may flow from the private purchase of the complaining stockholder's shares as a mode of "settling" litigation of a representative character without the judicial supervision which would be obtained in a direct compromise of the suit under Rule 23 (c). There the district court discovered, after the event, that the defendants had not only purchased the complaining stockholder's shares but had also purchased a substantial part of the outstanding shares of the

The foregoing authorities, of course, are relied on here only as illustrative of the principle that a

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complaining class on the basis of representations and financial statements of a misleading character. The court thereupon sought to inquire into the bona fides of this "settlement" under its power and duty to pass upon a compromise of such litigation under Rule 23 (c) and appointed a special master to conduct an investigation. Upon petition for writs of mandamus and prohibition a majority of the Third Circuit (sitting *in banc*) held that the district court had exceeded its power in undertaking this inquiry because it went beyond the issues presented in the litigation and did not deal with a "compromise" of the claims as the court defined that term, and the action was still pending subject to court approval of a motion for its dismissal. The minority, consisting of Biggs and McLaughlin, J. J., considered that the investigation, while unduly broad in scope, was, in respects material here, within the issues. The minority urged that the purchases of the stock were tantamount to a compromise of the litigation, making the case "ripe for dismissal," which could not be accomplished without court approval under Rule 23 (c). Since, however, it appeared that by the time of the oral argument in the circuit court of appeals, the defendants had redeemed all the remaining shares, it may be doubted whether the district court's investigation could have resulted in further prosecution of the litigation and accordingly the defendants were actually successful in accomplishing their purpose of frustrating the suit.

See also, *Manufacturers Mutual Fire Insurance Co.* v. *Hopson*, 176 Misc. 220, 25 N. Y. S. (2d) 502 (N. Y. Sup. Ct. 1940), *aff'd*, 262 App. Div. 731, 29 N. Y. S. (2d) 139 (1941), *aff'd*, 288 N. Y. 668, 43 N. E. (2d) 71 (1942), where the complainant's securities were purchased at a price greatly in excess of the market, the pleadings were withdrawn from the court files, and a stockholder who later discovered this suit and its "settlement" attempted to carry on the litigation but was apparently barred from so doing by the running of the statute of limitations.

class cause of action does not become the individual asset of the person instituting it, and that accordingly, any effort to dismiss or compromise it requires the exercise of the court's equitable jurisdiction to protect members of the class affected. We do not regard the practice of giving notice and opportunity to intervene to members of the class in the event of a proposal to dismiss or compromise as exhausting the equity jurisdiction of the court in which the suit is pending. At a later point we discuss the problem of appropriate equitable relief under the circumstances of the present case (see Point III, *infra*).

The appeal by Potts and Boag was as inherently representative as a stockholder's derivative suit. Defenses to the claim of Bradley and Murphy were primarily available to the debtor corporation, and Potts and Boag were in effect seeking to enforce a secondary right available to the stockholders upon the failure of any other representative of the corporation to act. Just as recovery in a stockholder's derivative action goes to the corporation, and the benefit to individual stockholders results only from the increased value of their equity, so here Potts and Boag could have recovered no monetary judgment for themselves by winning the appeal. Instead, like all other stockholders participating in the reorganization, they would have benefited indirectly through the improved debt position of the debtor corporation.

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The representative character of their appeal is also illustrated by its similarity to appeals in an ordinary bankruptcy proceeding by one creditor from an order allowing the claim of another creditor. The courts have generally held that such appeals must be brought by the trustee as the representative of all the creditors or, upon his refusal to act, by a creditor in the name of the trustee. *Chatfield* v. *O'Dwyer*, 101 Fed. 797 (C. C. A. 8, 1900); *Ohio Valley Bank Co.* v. *Mack*, 163 Fed. 155 (C. C. A. 6, 1906); *Fred Reuping Leather Co.* v. *Ft. Greene Nat. Bank*, 102 F. (2d) 372 (C. C. A. 3, 1939). See also, under Section 77B, *Jonas* v. *Bellerive Inv. Co.*, 90 F. (2d) 688 (C. C. A. 8, 1937); certiorari denied, 302 U. S. 724; *Christian* v. *R. Hoe & Co.*, 79 F. (2d) 541 (C. C. A. 2, 1935). Under Chapter X, however, creditors and stockholders have been permitted to appeal in their own name from orders primarily affecting the estate on the theory that Congress, in specifically giving them the right to be heard, intended to give the right to appeal.[11] These liberal provisions for direct investor participation effected no change in

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[11] See Sections 169, 174, 179, and 206, and see *In re Keystone Realty Holding Co.*, 117 F. (2d) 1003 (C. C. A. 3, 1941); and *Dana* v. *S. E. C.*, 125 F. (2d) 542 (C. C. A. 2, 1942). Similarly, as to railroad reorganizations, see Section 77 (c) (13). Under Section 77B creditors and stockholders had the right to be heard on the permanent appointment of the trustee, on the proposed confirmation of a plan, and on such other questions as the judge should determine. Section 77B (c).

the essentially representative nature of appeals in a bankruptcy proceeding which, if successful, would benefit others than the appellant. These provisions presumably were in recognition of the diverse and conflicting interests involved in bankruptcy reorganizations which might not be adequately represented by a single representative of the entire estate. The effect of the new statutory provisions is to permit direct attack on the fairness of the plan and review of an adverse ruling as to fairness in lieu of the equity receivership practice under which the creditors had an individual right to attack the plan collaterally for the purpose of reaching assets inequitably diverted.[12]

2. The fact that the appeal by Potts and Boag was not expressly designated as a class suit cannot discharge them from the obligations resulting from its representative nature. Although courts have sometimes required certain types of actions to be expressly designated as representative,[13] this requirement is a preventative against abuse, and the power of courts to protect the rights of others who might be involved is not dependent upon such

[12] See page 25, *infra*.

[13] *Hayden* v. *Perfection Cooler Co.*, 227 Mass. 589, 590–91, 116 N. E. 871 (1917) (stockholder's derivative action); *Geo. W. Signor Tie Co.* v. *Monett & S. W. Construction Co.*, 198 Fed. 412, 413 (E. D. Mo.) (creditor's action to recover unpaid stock subscriptions); *Terry* v. *Little*, 101 U. S. 216 (creditor's action to enforce stockholder's "double liability"); *Alsop* v. *Conway*, 188 Fed. 568, 575 (C. C. A. 6), certiorari denied, 223 U. S. 720 (same).

designation.[14] In *Sprague* v. *Ticonic National Bank,* 307 U. S. 161, this Court recognized the comparative unimportance of the label attached to a suit affecting a class. That case involved a claim for counsel fees and litigation expenses on behalf of a depositor of a closed bank who had established her right to priority of her own deposit by a suit prosecuted in her individual behalf. By reason of *stare decisis* the litigation of her claim established the rights of an entire class of depositors similarly situated. In holding that she was not barred from receiving compensation from the fund payable to all other depositors similarly situated, this Court stated (at pp. 166–167):

> That the party in a situation like the present neither purported to sue for a class nor formally established by litigation a fund available to the class, does not seem to be a differentiating factor so far as it affects the source of the recognized power of equity to grant reimbursements of the kind for which the petitioner in this case appealed to the chancellor's discre-

[14] An action to set aside a conveyance as a fraud on creditors, not designated as a class suit, has been construed as if brought in the name of a class, as required by statute. *Honesdale Shoe Co.* v. *Montgomery, supra* note 8. Similarly, no matter how designated, an individual seeking relief which is only available in a general creditor's action does not have the same right to dismiss the action which is available to a party in individual litigation. *Naspo* v. *Summit Sweet Shoppe,* 106 N. J. Eq. 49, 150 Atl. 199 (1930), *supra* note 8. And see *Wood* v. *Dummer,* 3 Mason 368, 30 Fed. Cas. 435, 440 (Case No. 17,944, C. C. D. Maine, 1824).

tion. * * * Whether one professes to sue representatively or formally makes a fund available for others may, of course, be a relevant circumstance in making the fund liable for his costs in producing it. But when such a fund is for all practical purposes created for the benefit of others, the formalities of the litigation--the absence of an avowed class suit or the creation of a fund, as it were, through *stare decisis* rather than through a decree—hardly touch the power of equity in doing justice as between a party and the beneficiaries of his litigation. As in much else that pertains to equitable jurisdiction, individualization in the exercise of a discretionary power will alone retain equity as a living system and save it from sterility.

While the *Sprague* case involved only the right of an individual plaintiff against the beneficiaries of her action, we submit that the power of a court of equity to do justice "as between a party and the beneficiaries of his litigation" requires the recognition of concomitant responsibilities attaching to a party seeking to establish common or derivative rights under the aegis of a bankruptcy court whether or not his suit is formally designated as representative.[15]

3. The status of Potts and Boag as members of a protective committee precluded them from appealing solely on their own behalf. In our

[15] Cf. Hornstein, *Problems of Procedure in Stockholders' Derivative Suits* (1942), note 9, *supra*, at p. 584.

memorandum in support of the petition for certiorari we did not address ourselves to petitioner's argument that Potts and Boag owe a duty to account because of their past connections with protective committees for the preferred stockholders. However, since the writ was granted without restriction, we now state our reasons for agreeing with petitioner that these past connections are sufficient in themselves to charge Potts and Boag with fiduciary responsibility to other stockholders of the debtor.

Potts and Boag had initially voiced objections to the junior debt claim while acting in a representative capacity, as members of a protective committee for the preferred stockholders. As this Court has held, protective committee members are fiduciaries, bound to give loyal and disinterested service in the interest of those for whom they purport to act; they cannot serve both their beneficiaries and themselves where there is any possibility of conflicting interest. *Woods* v. *City National Bank and Trust Co.*, 312 U. S. 262; *American United Mutual Life Insurance Co.* v. *City of Avon Park,* 311 U. S. 138. Congress, in Chapter X, has recognized the importance of judicial control over protective committees and their members in bankruptcy reorganization proceedings by authorizing the reorganization court to scrutinize the provisions of their agreements and authorizations, with power

to nullify any provision which is found to be unfair or not consistent with public policy (§ 212). They must also file with the court a statement under oath setting forth their powers, the history of their formation, the amounts of various securities held by them, the amounts paid therefor and the amounts of the claims or stock which they represent (§ 211). Their compensation for services rendered in the reorganization must be disallowed if they have traded in the claims or stock of the debtor (§ 249), and the court is empowered to limit any claim or stock acquired by a committee in contemplation or in the course of the proceeding to the actual consideration paid therefor (§ 212). The clear purpose of these provisions is to avoid creation of conflicting interests which might interfere with the discharge of fiduciary responsibilities assumed in connection with a reorganization and also to avoid inequitable profits from inside information acquired in a fiduciary capacity. From the point of view of both considerations the fiduciary relationship once assumed must be held to impose continuing limitations upon the fiduciary's freedom of action.

Having voluntarily assumed this status, Potts and Boag could not shuffle off their fiduciary responsibilities merely by resigning from the committee and proceeding in their own names. If a committee member could always resign his re-

sponsibilities whenever he discovered a means of securing profit for himself and thus forestall accounting to those he has represented, the elaborate statutory provisions for the protection of those represented would be thwarted. This cannot be permitted. Thus, under Section 249, an attorney has been denied compensation for services to a committee where the attorney had trafficked in the debtor's securities prior to the time he represented that committee but while he was representing another committee from which he later resigned. *In re Reynolds Investing Co.*, 130 F. (2d) 60 (C. C. A. 3, 1942). The court there observed: "If the conclusion were otherwise, a fertile field of fraud would be opened. By the mere expedient of a change of client or of a cestui que trust in the proceeding an attorney or trustee could receive compensation otherwise prohibited to him."

It is not necessary to determine whether under any circumstances it would be possible for a committee member to resign and thereafter participate in the proceeding in disregard of the rights of those he had previously represented. In this case it is clear that not only did Potts and Boag take no effective steps after their resignation to apprise other stockholders that they no longer acted in a representative capacity, but they actively fostered the impression that they continued in such a capacity. They represented to stock-

holders that they had formed a committee of their own for the purpose of further objecting to the plan and they refrained from notifying these stockholders that they had decided to institute the appeal solely on their own behalf.[16] In failing to make any effort to prevent other security holders from being lulled into sleeping on their rights in reliance upon the assurance that they were continuing to act for the security holders, Potts and Boag are in no position to contend that they were free to profit from the sale of their appeal by the device of appealing in their individual names.

II

IT IS INEQUITABLE AND CONTRARY TO THE AIMS OF BANKRUPTCY REORGANIZATION TO PERMIT POTTS AND BOAG TO RETAIN THE FRUITS OF THEIR SALE OF THE APPEAL

In this case Potts and Boag, by jettisoning the rights of others for their own gain, brought about a result which violates a fundamental principle of

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[16] Potts testified that in response to a letter he and Boag sent out under the name of Independent Preferred Stockholders Committee, in which they had urged stockholders to disapprove the plan and "Without any obligation whatsoever" to "join in this fight to the finish," they received "a few" replies from stockholders, some of whom "expressed a desire that the objections be prosecuted" (R. 178, 186). No further communications were sent out and Potts admitted that certain of the replying stockholders may well have thought that their interests continued to be represented by the Independent Preferred Stockholders Committee (R. 187).

bankruptcy reorganization calling for equal treatment of security holders of the same class unless there are special equities calling for subordination. See *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, 97. Having strenuously contended that the confirmed plan was inequitable to all preferred stockholders, they abused the privilege of participation which the statute accorded them by exacting additional compensation for themselves to still their objections. Through the device of selling their securities they prevented the appeal, which they had taken on the ground that the plan was unfair, from ever reaching a hearing by an appellate court. They also avoided an outright compromise of their contentions under the auspices of the bankruptcy court (compare Sec. 27 of the Act). The power and duty of the bankruptcy court to correct this highly inequitable result stems from the fact that it is a court of equity, and that in reorganization proceedings the court has a broad responsibility to make sure that the judicial power is not perverted to cause inequitable results.[17]

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[17] In *American United Mutual Life Insurance Co.* v. *City of Avon Park*, 311 U. S. 138, 145–146, this Court declared:

> As this Court stated in *Securities and Exchange Commission* v. *United States Realty & Improvement Co.*, 310 U. S. 434, 455: "A bankruptcy court is a court of equity, § 2, 11 U. S. C., § 11, and is guided by equitable

This power and duty are emphasized by reference to the central purpose of the statutory provisions whereby bankruptcy reorganizations have largely superseded the reorganization function of the equity receivership. A compelling reason for bringing corporate reorganization within the Bankruptcy Act was the need for efficient judicial supervision and control capable of fairly and finally determining the rights of

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doctrines and principles except in so far as they are inconsistent with the Act. . . . A court of equity may in its discretion in the exercise of the jurisdiction committed to it grant or deny relief upon performance of a condition which will safeguard the public interest." And see *Pepper* v. *Litton*, 308 U. S. 295, 304 *et seq.* * * * Where * * * investigation discloses the existence of unfair dealing, a breach of fiduciary obligations, profiting from a trust, special benefits for the reorganizers, or the need for protection of investors against an inside few, or of one class of investors from the encroachments of another, the court has ample power to adjust the remedy to meet the need. The requirement of full, unequivocal disclosure; the limitation of the vote to the amount paid for the securities (*In re McEwen's Laundry, Inc.*, 90 F. (2d) 872); the separate classification of claimants (see *First National Bank* v. *Poland Union*, 109 F. (2d) 54, 55); the complete subordination of some claims (*Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307; *Pepper* v. *Litton*, *supra*), indicate the range and type of the power which a court of bankruptcy may exercise in these proceedings. That power is ample for the exigencies of varying situations. It is not dependent on express statutory provisions. It inheres in the jurisdiction of a court of bankruptcy.

security holders in one proceeding.[18] Under prior practice the necessity for ancillary proceedings sometimes resulted in claimants of the same class receiving different degrees of participation.[19] Further inequities resulted from the fact that prior to receivership, those seeking control of a reorganization sometimes arranged for payments to claimants or their attorneys who threatened to institute a receivership in a forum deemed undesirable.[20] Even when all the debtor's property was within the jurisdiction of a single

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[18] "It is believed that such a process in bankruptcy will have great advantages over the cumbersome form of procedure under creditors' bills which has been evolved in the Federal equity courts. * * * The equity process frequently requires expensive and uncoordinated ancillary proceedings in many courts. Effective reorganization is often dependent upon costly and long-delayed foreclosure proceedings. The Federal courts in the conduct of these proceedings are charged with responsibility through their receivers during long periods of time, for the management of extensive business properties. The reorganization plan under which a committee buys in the property at foreclosure is not brought within the effective supervision and control of the court. Creditors who do not appear in the proceedings may in later years appear and enforce their claims against the reorganized company, if the plan has not adequately protected their interests." *Report of the Attorney General on Bankruptcy Law and Practice*, Sen. Doc. No. 65, 72d Cong., 1st Sess. (1931), 90.

[19] See Note, *Proof of Pre-Receivership Claims and Distribution of Receivership Assets in Primary and Ancillary Jurisdictions*, (1934) 82 U. of Pa. L. Rev. 848.

[20] *Cf.* Rodgers and Groom, *Reorganization of Railroad Corporations under Section 77 of the Bankruptcy Act*, (1933) 33 Col. L. Rev. 571, 589.

court, the machinery for reorganization provided by equity receivership was not adequate to assure equal participation by all security holders of the same class. Such reorganizations were effected through a sale of the property and its transfer to a new corporation under a plan by which various security holders were given a measure of participation determined by representatives of various groups. Although equity courts evolved doctrines of fairness as between security holders, the court in which the sale took place had only a limited supervision over the terms of the plan. Nor were the rights of claimants against the old corporation necessarily determined by the receivership court. Individual security holders could become parties only by intervention, which was in the discretion of the court, and a dissenter who did not intervene could subsequently attack the sale collaterally as a fraudulent conveyance and seek to enforce an individual right against the assets.[21]

[21] Instances of such methods of attack on unfair plans are *Railroad Company* v. *Howard*, 7 Wall. 392 (1868); *Northern Pacific Ry. Co.* v. *Boyd*, 228 U. S. 482 (1913). As recently as the *National Radiator Co.* case, *First National Bank of Cincinnati* v. *Flershem*, 290 U. S. 504, 521 (1934), where this Court reversed the action of the courts below in holding that a court of equity had jurisdiction to appoint a receiver and provide for a receivership sale to reorganize a solvent corporation, it was indicated that the effect of the successful challenge to the plan was limited to such creditors as had objected, but would not affect the status of approximately 95% of the holders of securities of the same class which had

Whether such a dissenter's attack should succeed depended not only upon the existence of unfairness in the plan but also upon the non-existence of equitable defenses against him in his individual capacity.[22] Thus, from the standpoint of the overall reorganization, the machinery developed in the equity courts was sometimes inadequate to prevent security holders of the same class from receiving unequal participation in the assets.

The bankruptcy reorganization statutes, designed to meet the foregoing inadequacies of equity reorganizations, give a single court of bankruptcy jurisdiction over all claims against the debtor and power to supersede all proceedings commenced in other courts in order that

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been deposited in support of the reorganization plan. The Court said:

"* * * The debenture holders who, by assenting to the Plan, cooperated with the Corporation and the Reorganization Committee, are in no position to complain that these petitioners will fare better than they. Compare *Davis* v. *Virginia Ry. & Power Co.*, 229 Fed. 633, 642. Since the assets fraudulently conveyed far exceed the amount of the claims of all non-assenting creditors, none of these could have occasion to object to the payment of these petitioners in full."

In *Northern Pacific Railway Co.* v. *Boyd*, *supra*, a collateral attack made by an unsecured creditor seven years after the confirmation of the sale was successful. It was held that relief was not precluded although another creditor on behalf of himself and all other creditors holding contingent and unsecured claims had unsuccessfully made a similar challenge to the fairness of the plan in the original receivership proceeding.

[22] See cases cited, footnote 21, *supra*.

each claimant may receive an equitable participation in the assets of the estate and that a race of diligence among them may be avoided.[23] To this end all the assets of the debtor wherever located are in the custody of the court and their administration is supervised by the court. No plan of reorganization can be effected unless, after a hearing upon notice to all claimants, the court finds it to be fair. Nor can any modification of the plan be made without court approval. Thus, the collateral attacks which were possible in equity receiverships are eliminated and the statute provides for final determination of the participation of all claimants based upon principles of fairness and equity. Whether or not they actively take part in the proceeding, all claimants are entitled to rely upon the exercise by the court of its supervision over all steps of the reorganization with a view to ensuring that their interests are fairly compensated. We have seen that one of the principles of fairness and equity is equal treatment of all who have claims of the same rank. Thus, a plan cannot be held unfair to one litigant unless it is held unfair to all other participants in the same situation. Consequently, there can be no compromise on terms beneficial solely to the objector of contentions than a plan is unfair; the

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[23] *Cf.* James A. McLaughlin, Hearing Before the House of Representatives Committee on the Judiciary on H. R. 8046, 75th Cong., 1st Sess. (1937), 8–11.

only permissible form of "compromise" is an offer to improve the position under the plan of the entire class sought to be benefited by the objection.

Section 222 of the Act, specifically providing for modification of a Chapter X plan before or after its confirmation, sets forth a procedure whereby the judge can pass upon any such proposal to "compromise" contentions respecting the fairness of a plan. In requiring any changes in rights dealt with in the plan to be passed upon by the court (and when they materially and adversely affect classes of security holders, to be accepted by the requisite number thereof), Section 222 affords protection with respect to modifications of a plan similar to that bestowed upon the original plan. This procedure is necessarily applicable where a contention that a plan is unfair has been established on appeal, unless the appellate determination requires a completely new plan to be effected. It must have been intended to be equally applicable where settlement of such a contention is effected.

That this is the solution to the problems arising from agreements to sell an appeal concerning the fairness of the plan, under circumstances like that of the present case, is compelled by the fact that any settlement outside the framework of the plan would undermine the objective of the Act to have the participation of all classes of claimants fairly and finally determined under the auspices of the

reorganization court. If individual litigants could keep for themselves the proceeds of whatever deal they might effect, the door would be open to infirmities similar to those incident to the equity procedure which the reorganization statutes were intended to cure. A new race of diligence would result since participants might object to reorganization plans and prosecute appeals therefrom even where they have no basis for believing their objections to be sound, in the hope of exacting from other interested participants something more than the amounts received by fellow members of their class.[24] Benefits to security holders from a reorganization would thus depend upon their skill in negotiation rather than upon principles of equity, and the right of security holders to take part in the proceeding would become an instrument of inequity and delay instead of an aid in the formulation of a plan.

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[24] Section 203 authorizes the Court to disqualify for the purpose of voting on a plan, any claim or share, the holder of which is accepting or refusing to accept the plan in bad faith. While a security holder may thus not properly object to a plan for the purpose of getting a nuisance value for his security, the device of permitting him to demand this nuisance value at the appellate stage, without exacting any penalty for such misconduct, will clearly result in circumventing the purpose of Section 203. *Cf. Texas Hotel Securities Corp.* v. *Waco Development Co.*, 87 F. (2d) 395 (C. C. A. 5), certiorari denied, sub nom. *Waco Development Co.* v. *Rupe*, 300 U. S. 679. See also William O. Douglas, Hearings before the House of Representatives Committee on the Judiciary on H. R. 8046, 75th Cong., 1st sess. (1937), pp. 183–184; and John C. Knox, *ibid.*, 365–366.

A construction requiring that any settlement of contentions as to fairness of a plan must be brought within the framework of the plan places no unfair burden upon persons undertaking to represent the interests of a class. Such persons, having acted in a proper manner and without attempting to appropriate any fruits of the "compromise" for themselves, can rely on the court to compensate them for any benefits they achieve for the estate as a result of their efforts. *In re Keystone Realty Holding Co.*, 117 F. (2d) 1003, 1006 (C. C. A. 3, 1941); and *Sprague* v. *Ticonic National Bank*, 307 U. S. 161, *supra*.[25] Nor would such a construction preclude settlements in the interest of termination of the litigation. It would require only that upon the abandonment of an appeal any concession made by the appellee should be through a modification of the plan.[26]

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[25] *Cf.* Section 243 of the Act, giving the judge of the reorganization court power to allow reasonable compensation for services rendered by creditors and stockholders, and Section 249, forbidding compensation to "any committee or attorney, or other person acting in the proceedings in a representative or fiduciary capacity, who at any time after assuming to act in such capacity has purchased or sold" securities of the debtor without the consent of the judge. These provisions would be nullified if persons in a representative capacity were permitted to appropriate the fruits of the settlement through sale of their securities.

[26] It is true that even where such a modification is proposed the appellate court might permit another party to intervene and carry on the appeal. It is unnecessary here to consider in what circumstances such intervention might be deemed appropriate.

In the present case the fact that all participants were subjected to the disadvantage of delay in consummation of the confirmed plan during the pendency of the appeal by Potts and Boag; the fact that Potts and Boag sold out at a time when they alone held the bargaining power of the entire class, since the time for appeal from the confirmation order had then expired; and the fact that the holders of the junior debt paid more than the improved position that Potts and Boag had sought for themselves by the appeal, indicate that the payment was indistinguishable from a compromise of the participation of the junior debt under the plan, except that Potts and Boag appropriated to themselves the entire proceeds from selling the class suit. Even where a plan has the affirmative support of the statutory percentage of security holders the court has a responsibility for the fairness of treatment of all affected, and cannot tolerate a "concealed compromise" of disputed issues relevent to the fairness of the plan which side-steps judicial supervision. Cf. *Consolidated Rock Products Co. v. Du Bois,* 312 U. S. 510, 523. In settling their contentions through a sale of their securities and thereby avoiding the statutory machinery designed to prevent an inequitable result, Potts and Boag violated the responsibility they undertook when they sought to enforce class rights by appeal.

III

POTTS AND BOAG SHOULD BE DIRECTED TO PAY OVER TO THE DEBTOR THE CONSIDERATION THEY RECEIVED FOR SELLING THE APPEAL

Since the proper procedure for a compromise of the contentions made by Potts and Boag would have been through an amendment to the reorganization plan, which would presumably have reduced the participation accorded the junior debt claim by the amount Potts and Boag received as consideration for dismissing the appeal, such procedure would have benefited all participants subordinate to the junior debt. An equitable result can be reached here by requiring Potts and Boag to pay over to the debtor the consideration they received for ending the appeal. This increase in the assets of the debtor will benefit junior security holders who have participated under the plan substantially to the same extent as if the debt had been decreased in that amount.

Such relief is not barred by the orders of the circuit court of appeals denying Young's application to intervene and dismissing the appeal. Although Young's earlier application, like the application under consideration here, was predicated on the ground that respondents were prosecuting their appeal as representatives of the preferred stockholders, there exists no basis for *res judicata*. In opposition to Young's application to intervene

and continue the appeal, it was properly urged that he had failed to object to the confirmation of the plan and that he had ulterior motives. Certainly, in determining whether to permit Young to continue the appeal, the court was entitled to find that his failure to object to the plan in the lower court estopped him from contesting its inequity at the appellate level. Effective appellate administration and proper functioning of reorganization machinery both require an appellate court, in the absence of strong countervailing equities, to refuse to hear objections to a plan which are offered by a person who failed to urge them in the reorganization court. *Cf. In re Prudence Bonds Corp.*, 79 F. (2d) 205 (C. C. A. 2), certiorari denied, 296 U. S. 652. The ulterior motives urged on the prior application were presumably the same actions of Young complained of on the instant application—that his purpose was to prevent abandonment of the appeal by Potts and Boag prior to the time when he would be able to foreclose and acquire possession of the stock and debt claims held by Bradley and Murphy. If the circuit court of appeals was persuaded of the truth of such allegations, it could hardly have found that Young was a proper party to carry on the appeal and contest the participation accorded the junior debt under the plan when the very purpose of his intervention was to gain time in which to acquire that debt for himself, after which he

would, of course, have no interest in demanding its subordination.

However, neither the fact that Young did not object to the plan in the reorganization court nor that he may have had ulterior motives in seeking to intervene on the earlier appeal is reason to deny the relief sought in this proceeding to require Potts and Boag to pay over the consideration they received for selling their appeal. Where appeals from confirmation orders on the ground of unfairness of the plan have been successful, the new plans have made no distinction between security holders who accepted and security holders who objected to the plans originally confirmed.[27] Clearly, acceptance of a bankruptcy reorganization plan is not a waiver of rights to equality of treatment. Nor does the obligation of the reorganization court to require fair treatment to all security holders rest on the identity of the moving party. So long as the facts are properly before it, the court is free to exercise its power to prevent perversion of its order confirming the plan by acting on its own motion. If it should find that Young is not a proper party to prosecute an accounting suit for the estate, the court can appoint a satisfactory representative to do so.

There can be no presumption that, in permitting the abandonment of the appeal after finding that

[27] E. g., cf. plan in *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307, with plan in *Standard Gas & Electric Co.* v. *Deep Rock Oil Corp.*, 117 F. (2d) 615 (C. C. A. 10, 1941).

no qualified person sought to carry it on, the court condoned the retention by Potts and Boag of the proceeds of their sale. It was never contemplated that an appellate court which has before it only one aspect of the reorganization proceeding should undertake to administer the entire reorganization machinery. It must be assumed that questions as to the proper disposition of the proceeds received by Potts and Boag for abandonment of their appeal were left for determination by the reorganization court which has before it the entire reorganization and is in a position to integrate the proceeds with the plan.

By refusing to permit Potts and Boag to retain the consideration they received for ending the appeal, this Court will set no precedent which will handicap the proper compromise of appeals from orders of confirmation. It will require only that such compromises be made within the framework of the plan of reorganization subject to the scrutiny of the reorganization court and therefore benefit all who would have benefited had the appeal been successful. Incentive to fight for fair plans will not be curtailed since, as we have pointed out, those establishing common rights are undoubtedly entitled to an allowance reflecting the extent to which their services benefit the estate or the class of investors affected. Such a determination will, however, clearly establish that the just and expeditious reorganization of estates may

not be impeded in the interests of those seeking unjust enrichment out of the reorganization.

In our memorandum in support of the petition for a writ of certiorari we pointed out that the issues in this case are of importance in the administration of the Public Utility Holding Company Act of 1935. The Commission has had at least one experience where stockholders of a registered holding company sought review of a Commission order approving a reorganization plan and thereafter abandoned their petition before hearing on the merits under circumstances which would seem to indicate that their securities had been purchased in excess of their fair value. While the provisions of the Holding Company Act broadly permit any security holder "aggrieved" by the Commission's order to file a petition for review, it is the Commission's view that such proceedings are representative in character. Application in the context of the Holding Company Act of the principles which we urge in this brief may present procedural problems which are not involved here and which the Court need not now consider. However, a decision in this case that security holders may retain the fruits of selling out an appeal would afford the same encouragement to abuse of the privilege of individual security holders to seek review of orders

affecting class rights under the Holding Company Act as would be the case in the application of such a ruling to Chapter X appeals. Under neither statute would the result be consonant with the legislative intention or proper respect for the judicial process.

CONCLUSION

The judgment of the court below should be reversed.

Respectfully submitted.

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January, 1945.

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SUPREME COURT OF THE UNITED STATES.

No. 342.—October Term, 1944.

Robert R. Young, Petitioner,
vs.
The Higbee Company, William W. Boag and J. F. Potts.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Sixth Circuit.

[February 26, 1945.]

Mr. Justice Black delivered the opinion of the Court.

This case presents the question of the accountability of stockholders who objected to the confirmation of a plan of reorganization under the Bankruptcy Act,[1] and abandoned their appeal for a consideration to themselves, where the basis of the appeal was that, if successful, it would benefit the entire class.

The Higbee Company, a department store with assets of more than six million dollars, filed a voluntary petition for reorganization. It had three types of stocks, common, and first and second preferred. Two of its directors, Bradley and Murphy, claimed that they had acquired by purchase a junior debt against the company of $1,952,000.00. A plan for reorganization was presented under which the owners of this junior debt were to be awarded $600,000.00 in new notes and a large block of common stock. Potts and Boag, respondents here, and owners of some shares of first preferred, objected to confirmation of the plan. They contended, on several grounds, that unless the junior debt was subordinated to the preferred stock claims, the plan allotted that indebtedness too great a share in the distribution of the bankrupt's assets.[2] When the stockholders' committee of which they

[1] The proceedings were begun in 1935 under Section 77 B, 11 U. S. C. 207. June 22, 1938, Congress passed the Chandler Act, and the provisions of Chapter 10 of the Act were thereafter applicable to these proceedings. 52 Stat. 883-905, 11 U. S. C. 501-676.

[2] This $1,952,000.00 junior indebtedness consisted of subordinated notes of The Higbee Company which had been bought by Midamerica Corporation for $100,000.00 at an auction sale in 1935. Potts and Boag consistently maintained that the junior debt's participation in Higbee's assets should be limited to $100,000.00. They charged that Bradley was a director of Higbee and of Midamerica, and thus occupied two conflicting fiduciary positions. They insisted that the court should find this junior debt to be "invalid and unenforceable in whole or in part" and "subordinated to the First and Second Preferred Stock."

were members approved the plan, Potts and Boag resigned and announced the formation of a new committee to press their objections to the junior debt allowance. Notwithstanding these objections, the Securities & Exchange Commission recommended the plan's acceptance, 8 S. E. C. 777, and the District Court confirmed it. Potts and Boag appealed from the District Court's decree confirming the plan. Although appealing as individuals, their appeal was based almost entirely on objections to allowances for the junior indebtedness which left less for distribution among all the preferred stockholders. Their appeal sought no separate individual relief for themselves; they appealed only to have the confirmation set aside. Had their appeal succeeded, the District Court would have been required to reduce the value of junior claims asserted by Bradley and Murphy, thereby increasing the value of the claims of the preferred stockholders as a class.

In this situation, Potts and Boag sold their stock and their appeal[3] to Bradley and Murphy, claimants under the junior debt; the consideration paid was $115,000.00. The par value of this stock was $26,000.00. Its admitted market value at the time, as the court below found, was $17,000.00. Pursuant to this contract for sale of the appeal a stipulation for dismissal was filed in the Circuit Court of Appeals. Petitioner Young, a preferred stockholder of the same class, sought to intervene and prosecute the appeal. His petition was denied and the case was dismissed without opinion. Young then, on behalf of himself and all other preferred stockholders, filed a petition in the District Court setting up these facts and praying that he be authorized to employ counsel to compel Potts and Boag to account to the debtor for the

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[3] Potts' testimony as to the sale was:

"Q. So that in a sense you were selling something more than your stock, I take it? A. I think so.

"Q. You were selling the appeal which you had taken in behalf of yourself and Mr. Boag; that is a fair statement, isn't it? A. I think so."

The written contract between Potts and Boag and Bradley and Murphy specifically provided for sale of the appeal as well as the stock. It reads in part:

"I hereby sell, assign, transfer and set over unto Charles L. Bradley and John P. Murphy, and their assigns, 260 shares of First Preferred stock of The Higbee Company, of Cleveland, Ohio, . . . together with all rights, title and interest, benefits or privileges we, or either of us, have or may have in and to or by virtue of or arising from the matter of The Higbee Company, Debtor, J. Fred Potts and William W. Boag, Appellants, vs. The Higbee Company, Appellee, and a certain appeal taken by J. Fred Potts and William W. Boag in said proceedings, which said appeal is now pending in the United States Circuit Court of Appeals for the Sixth Circuit. . . ."

difference between what they received and the fair value of their stock, or praying in the alternative that Potts and Boag be required to pay over that amount to the preferred stockholders.[4] After a hearing, a special master found as a fact that Potts and Boag had appealed in behalf of themselves only and had not acted as representatives of a class. The District Court approved this finding, thought it determinative of the case, and dismissed Young's petition. The Circuit Court of Appeals affirmed. 142 F. 2d 1005. Because considerations of substantial importance to the effective administration of corporate reorganizations are involved, we granted certiorari, — U. S. —.[5]

First. It is argued that since the Circuit Court of Appeals dismissed the appeal of Potts and Boag over Young's attempt to intervene, Young is estopped from prosecuting the present petition. This contention has no merit, for the reason, among others, that the determinative issues in the two proceedings were not the same. The first petition did not pray for an accounting by Potts and Boag. The court only decided then that Young could not intervene and continue that appeal, and that the appeal should be dismissed. Now, accepting the court's dismissal of the appeal as final, Young seeks an accounting for the consideration paid Potts and Boag for agreeing to dismiss.

Second: It is argued that since Potts and Boag did not expressly specify that they appealed in the interest of the whole class of preferred stockholders, but appealed only in their own names, they owed no duty to any stockholders but themselves. The appeal here, however, was not from a denial of any individual claim of Potts and Boag. Its basis was that every other preferred stockholder, as well as themselves, would be injured by confirmation. So far as the issues raised by the appeal are con-

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4 In both courts below Young sought an order against Bradley and Murphy as well as Potts and Boag but Bradley and Murphy have not been made respondents in this Court.

5 The petitioner has made the following statement to this Court with reference to the respondent Boag:

"During the course of the appeal in the Circuit Court of Appeals it first came to Petitioner's attention that Respondent Boag had entered the Armed Services. No one representing Boag has appeared to request a stay of proceedings pending his return. However, Petitioner has no desire to cause judgment to be entered against Boag under these circumstances. It would be entirely satisfactory to have the proceedings stayed as to Boag pending his return, although no rights against him are waived."

Under these circumstances no judgment against Boag will be entered in this case and the proceedings in the Circuit Court of Appeals will be stayed as to him. Soldiers' & Sailors' Civil Relief Act of 1940, 54 Stat. 1178.

cerned, the rights of Potts and Boag and the other preferred stockholders were inseparable. Thus, even though their objection to confirmation contained no formal class suit allegations, the success or failure of the appeal was bound to have a substantial effect on the interests of all other preferred stockholders. The liability of one who assumes a determining position over the rights of others must turn on something more substantial than mere formal allegations in a complaint.[6] Equity looks to the substance and not merely to the form.

Furthermore, the right of appeal granted by a statute should not be interpreted in such way as to defeat rights clearly granted in other parts of the same Act. *Peck* v. *Jennes et al.*, 7 How. 612, 623. Potts and Boag appealed under Sec. 206 of the Chandler Act, which, contrary to the general bankruptcy procedure, grants any stockholder or creditor the right to be heard on all matters relating to corporate reorganizations. Courts have liberally construed this language as authorizing appeals.[7] We are now asked to say that the privilege of appeal granted to Potts and Boag by the Act vested them with an indefeasible right to sell the privilege to the disadvantage of all other stockholders in their class. But, historically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets; to protect the creditors from one another.[8] And the corporate reorganization statutes look to a ratable distribution of assets among classes of stockholders as well as creditors. There would be no ratable distribution of this bankrupt estate if Potts and Boag could utilize their statutory right of appeal to get for their preferred stock $7.00 for every $1.00 paid to other preferred stockholders. We are asked to say that Congress intended such a consequence, and to construe the right of a stockholder to be heard on a plan of reorganization as carrying with it the right to "sell" the very appeal which the Act grants him.

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[6] Sprague *v.* Ticonic Bank, 307 U. S. 161. See Atlas Bank *v.* Nahant Bank, 23 Pick. (Mass.) 480; Whitten *v.* Dabney, 171 Cal. 621; Honesdale Co. *v.* Montgomery, 56 W. Va. 397; Rawnsley *v.* Trenton Mutual Life Ins. Co., 9 N. J. Eq. 95; Wood *v.* Dummer, 30 Fed. Cas. 435, No. 17,944.

[7] In re Keystone Realty Holding Co., 117 F. 2d 1003; Dana *v.* S. E. C., 125 F. 2d 542; *cf.* Amick *v.* Mortgage Security Corp., 30 F. 2d 359.

[8] Boese *v.* King, 108 U. S. 379, 385-386; Sampsell *v.* Imperial Paper Corp., 313 U. S. 215, 219; cf. Case *v.* Los Angeles Lumber Co., 308 U. S. 106. See also 66 Pa. L. Rev. 224; Senate Document No. 65, 72nd Cong., 1st Sess., 6, 10, 49-93.

Potts and Boag, by appealing from a judgment which affected a whole class of stockholders owed an obligation to them, the full extent of which we need not now delineate. Certainly, at the very least they owed them an obligation to act in good faith. If Potts and Boag had declined to accept this plan in bad faith, the court, under Section 203[9] could have denied them the right to vote on the plan at all. The history of this provision makes clear that it was intended to apply to those stockholders whose selfish purpose was to obstruct a fair and feasible reorganization in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupt assets.[10] If Potts' and Boag's opposition to confirmation sprang from such a purpose (and Potts and Boag did obstruct confirmation until they were able to "sell" their appeal) they were acting in bad faith within the statutory meaning of that term. And accepting money as the end result of such a statutory violation cannot vest them with a right to keep it. Payment to them of this money simply meant that the distribution of bankrupt assets to the junior debt claimants who paid Potts and Boag, would represent a smaller net value. The statute contemplates, and the appeal was taken on the assumption, that the less the junior claimants were awarded the more all the preferred stockholders would re-

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9 "Sec. 203. If the acceptance or failure to accept a plan by the holder of any claim or stock is not in good faith, in the light of or irrespective of the time of acquisition thereof, the judge may, after hearing upon notice, direct that such claim or stock be disqualified for the purpose of determining the requisite majority for the acceptance of a plan." 52 Stat. 894.

10 A year before the House Committee on the Judiciary held its extensive hearings on the Chandler Act, a Circuit Court of Appeals held that a creditor could not be denied the privilege of voting on a reorganization plan under Sec. 77 B, although he bought the votes for the purpose of preventing confirmation unless certain demands of his should be met. Texas Hotel Corp. v. Waco Development Co., 87 F. 2d 395. The hearings make clear the purpose of the Committee to pass legislation which would bar creditors from a vote who were prompted by such a purpose. To this end they adopted the "good faith" provisions of Sec. 203. Its purpose was to prevent creditors from participating who "by the use of obstructive tactics and hold-up techniques exact for themselves undue advantages from the other stockholders who are cooperating." Bad faith was to be attributed to claimants who opposed a plan for a time until they were "bought off"; those who "refused to vote in favor of a plan unless . . . given some particular preferential advantage." Hearings on Revision of the Bankruptcy Act before the Committee on the Judiciary of the House of Representatives, 75th Cong., 1st Sess. on H. R. 6439, Serial 9, pp. 180-182.

See also, on the same general topic, McLaughlin, Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit, 46 Yale L. J. 421; Hornstein, Problems of Procedure in Stockholder's Derivative Suits, 42 Col. L. Rev. 574, Rodgers and Groom, Reorganization of Railroad Corporations under Section 77 of the Bankruptcy Act, 33 Col. L. Rev. 571, 588-601.

ceive. Therefore, the consideration of the sale which Potts and Boag made was not merely their own interest in the bankrupt estate, but the interest of all the preferred stockholders. The situation which enabled them to traffic in the interests of others was created by a statute passed to protect the interests of all of them.[11] The statute neither compels them to appeal nor to prosecute an appeal already taken contrary to their own interests; it does impose upon them the duty of good faith to all other stockholders whose interests they temporarily control because they are necessarily involved in the appeal. This control of the common rights of all the preferred stockholders imposed on Potts and Boag a duty fairly to represent those common rights.[12] This representative responsibility is emphasized by the fact that they might have been awarded compensation for their services had they succeeded in reducing the claim of the junior indebtedness to the advantage of all the preferred stockholders. Sec. 243; cf. Sec. 249. *In re Keystone Realty Holding Co.*, 117 F. 2d 1003, 1006. They cannot avail themselves of the statutory privilege of litigating for the interest of a class and then shake off their self-assumed responsibilities to others by a simple announcement that henceforth they will trade in the rights of others for their own aggrandizement. To hold that the Chandler Act permits this, would be to say that Congress, which sought more effectively to accomplish fair and equitable treatment of investors, had by granting a right of appeal to stockholders, defeated its purpose, and had substantially modified the whole body of law imposing the most rigorous responsibilities for fair dealing upon those who represent the rights of others.[13]

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[11] See Commission v. Sanders Radio Station, 309 U. S. 470, 476-7; I. C. C. v. Oregon-Washington R. Co., 288 U. S. 14, 25-7.

[12] By virtue of their standing as sole appellants, Potts and Boag, during the pendency of the appeal, dominated the fate of the reorganization as completely as though they had been the majority stockholders of a going corporation. Cf. Southern Pacific Co. v. Bogert, 250 U. S. 483, 492: "But the doctrine by which the holders of a majority of the stock of a corporation who dominate its affairs are held to act as trustees for the minority, does not rest upon such technical distinctions. It is the fact of control of the common property held and exercised, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation. . . . The essential of the liability to account sought to be enforced in this suit lies not in fraud or mismanagement, but in the fact that, having become a fiduciary through taking control of the old Houston Company, the Southern Pacific has secured fruits which it has not shared with the minority. The wrong lay not in acquiring the stock, but in refusing to make a pro rata distribution on equal terms among the old Houston Company shareholders.

[13] Cf. Woods v. City Bank, 312 U. S. 262, 267-269; Meinhard v. Salmon 249 N. Y. 458.

The money Potts and Boag received in excess of their own interest as stockholders was not paid for anything they owned. It came to them in settlement of litigation which if carried to a successful conclusion would have added to the value of other preferred stockholders of the common debtor. That the suit was settled and dismissed does not alter the rights of parties as to distribution of the fruits of the settlement. A distinction as to rights arising from litigation, which rests upon the difference between a judgment and a settlement of a lawsuit, under these circumstances, as in others, is "too formal to be sound." *Lyeth* v. *Hoey,* 305 U. S. 188, 195, 196; *Helvering* v. *Safe Deposit and T. Co.,* 316 U. S. 56, 63-67. The appeal of Potts and Boag was alleged to be for the benefit of all preferred stockholders. In the contemplation of the statute which authorized the appeal, its fruit properly belongs to all the preferred stockholders. One creditor, therefore, cannot make that fruit his own by a simple appropriation of it. Cf. *Terry* v. *Little,* 101 U. S. 216, 218.

Third: It is argued that even though the money paid in excess of the stock value does in equity and good conscience belong to the stockholders, the bankruptcy court is without power to award the relief prayed. Courts of bankruptcy are courts of equity and exercise all equitable powers unless prohibited by the Bankruptcy Act. *Securities and Exchange Commission* v. *United States* 310 U. S. 434, 455. The District Court still has jurisdiction to exercise its powers under the Act both because of its express reservation and because of the provisions of Section 222.[14] That power is ample to authorize the court to order an accounting for the funds in dispute here. *Pepper* v. *Litton,* 308 U. S. 295, 303-310; *American Insurance Co.* v. *Avon Park,* 311 U. S. 138, 145-147; *Consolidated Rock Co.* v. *DuBois,* 312 U. S. 510, 521-523.

Nor can we sustain the contention that relief should be denied on the allegations that Young's motive in bringing the proceeding is an unworthy one. His petition sought relief for the benefit of all the stockholders. The rights of these stockholders are not to be ignored because of some motive attributable to Young.

Reversed.

The Chief Justice and Mr. Justice Jackson concur in the result. Mr. Justice Roberts dissents.

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[14] This Section gives the judge power, under conditions applicable here, to alter and modify a reorganization plan even after confirmation.